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AMERICAN ACCOUNT Irwin Stelzer

Fears of inflation as workers turn militant over pay

HARRY TRUMAN complained that he could not find a one-handed economist; he said the on-the-one-hand, on-the-other-hand analysis that was his advisers' stock-in-trade was useless. Had Alan Greenspan been around when Truman was in office, he would have been exposed to the famous presidential temper.

The Fed chairman is often accused of obfuscation. But last week's testimony to Congress was crystal clear: Greenspan thinks the risk of inflation is "probably greater" than the risk of "protracted, excessive weakness in the economy". The most likely scenario is that the economy will grow 3%-3.25% this year, and 2%-2.5% in 1999, with unemployment at between 4.5% and 4.75% at the end of 1999. It would be hard to be more specific than that.

The economy grew at 5.5% in the first quarter. Were it to continue to grow at that rate, the Fed would have to raise interest rates - and by more than a little - to cool things off. Fortunately, that will not be necessary, at least if the following arithmetic - mine, not Greenspan's - proves correct. The General Motors (GM) strike will lop half a percentage point off growth; the fall in exports to Asia a full point; and the anticipated slowdown in stock building from the first quarter's frantic pace, another percentage point. This means growth for the rest of this year will be at least 2.5 percentage points below the first quarter's 5.5%, or a sustainable 3%, or even lower - some analysts say the economy actually contracted in the second quarter.

There are two key questions: how will Asia affect the economy? And what will happen to labour costs? The first is unanswerable, for continued Asian deterioration will produce both bad news and good news. The bad news is that exports, which have already dropped 15%, will continue to fall.

The good news is that an Asian failure to recover will depress demand for oil and other commodities and keep prices low, increase the flow of lower-priced imports into America and keep the dollar strong, all factors that will, says Greenspan, "continue to contribute to good price performance in the United States in the period ahead".

So if domestic demand remains robust, Asia's recession may prove a blessing. And domestic demand seems likely to remain strong. As Greenspan told Congress, soaring shares have added $12.5 trillion to the value of people's assets since 1994. Little wonder, as he put it, that "American consumers remain upbeat" and have been increasing spending at the fastest rate for more than 10 years. Indeed, as Greenspan gave his semi-annual report to Congress, the Department of Commerce said housing starts had risen 5.6% in June. Michael Carliner, a National Association of Home Builders economist, said: "Builders are having trouble keeping up with demand. Single-family home inventories are very tight."

The reason builders have trouble meeting demand is they cannot find workers. And they are not alone, which is Greenspan's worry. So far, higher demand for workers has been met by employing the jobless and wooing more people out of the home and into the labour market. Both of those sources of supply are exhausted. This means companies will have to lift productivity - get more product for every man-hour worked - to raise output.

So far productivity has risen, and has risen enough to permit employers to pay workers more while also holding unit labour costs down. But that party may now be over. Greenspan thinks "increasingly confident workers" may escalate pay demands so much that productivity will not rise fast enough to offset the bigger payouts, forcing employers to raise prices to maintain margins. That, he fears, would end America's "virtuous cycle" of rising productivity making possible rising wages, while costs stay down so that prices are restrained, giving consumers the wherewithal to spend and businesses the incentive to invest to meet rising demand.

Certainly there is cause for concern, and not only because of the accelerating trend in wages. Buoyed by the confidence that comes with the abundant jobs, workers are becoming more militant. The success of the United Auto Workers (UAW) in closing down GM is in contrast to its inability only recently to bring Caterpillar Tractor to heel: the pool of non-union replacement workers Caterpillar called on to break the UAW strike is no longer available.

And in what The New York Times described as "the biggest unionisation victory in the private sector in two decades", 19,000 United Airlines (UA) reservation agents and ticket sellers voted recently to join the machinists' union. This is ironic, because the airline is more than 50% worker-owned.

Union leaders say the UA victory proves white-collar workers can be attracted to unions and they have American Airlines' 15,000 white-collar staff as their next target. Even without revived unions, what Greenspan calls "stretched labour markets" may result in wage rises big enough to trigger inflation. If the car workers' militancy and effectiveness and the machinists' union's organising drive are harbingers of a tougher bargaining atmosphere, the Fed may have to raise interest rates before Christmas - unless, of course, by that time we have the stock market "correction of some significant dimension" that Greenspan says will inevitably come.

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